



The Future of Gaming is Networked

A Parks Associates White Paper

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Published by Parks Associates

© January 2006 Parks Associates
Dallas, Texas 75230

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Printed in the United States of America.

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1.0 Trends and Drivers for a Growing Market

1.1 Current Status

People have been playing multiplayer games for ages. From the ancient Olympics to *Mah-Jong*, an addictive four-player game invented in China 3,000 years ago, and to the parlor games popular during the Victorian era in England, multiplayer gaming has been fulfilling a need for entertainment, socialization, and competition. With the widespread proliferation of the Internet and the growing adoption of broadband service on a global basis, we are experiencing a new age of multiplayer gaming. Text-based MUD (multiplayer Dungeon/Domain) games, which took root on university mainframes during the late 1970s and early 80s, have become the popular massively-multiplayer online (MMO) games. *World of Warcraft*, the most popular MMO to date, signed up more than five million subscribers worldwide, with more than two million Chinese gamers, only one year after its launch. Its publisher, Blizzard Entertainment, is generating an estimated \$30 million a month in revenues.

1.2 Who's the User?

Not every online gamer is a teenage geek spending ten hours a day fighting monsters and slaughtering dragons in a virtual dungeon. Although many industry pundits still question statistics indicating that a large percentage of gamers are women in their late thirties or even forties, Web sites such as Pogo.com and Yahoo! games are attracting gamers of all ages and genders. Club Pogo, EA's subscription service for casual Web games, has signed up more than one million paying subscribers, each paying \$5 a month. EA says that 75% of the subscribers are women. And while most of U.S. gamers playing MMOG, Real-Time Strategy, and First-Person Shooter games are young and male, a larger percentage of female and older gamers play these games in Asia. Game developers and publishers in the U.S. are paying close attention to developments in South Korea and China, hoping to design online games that may appeal to diverse demographic groups.

1.3 What's Driving the Market Now?

The growing penetration of broadband, the diversification of online games that appeal to different tastes, and the emergence of different business models have spurred the growth of online PC gaming. Subsequently, online gaming has migrated onto other platforms including game consoles, portable game players, and even cellular phones. Microsoft has been a leader in the online console space. Its Xbox Live® service provides a unified interface and experience for its subscribers and has attracted more than two million paying subscribers. Microsoft is enhancing its online offerings with the release of Xbox 360™. The new service will not only feature a free tier but also add features such as Xbox Live Marketplace and MMOGs. While they have not divulged specifics, Sony and Nintendo have both hinted that online capability and networking support will be the focus of their next-generation consoles. Even the cellular phone platform, traditionally regarded as an inferior platform for serious gaming, is getting a boost from 3D graphics and next-generation cellular networks. Companies such as Qualcomm, NVIDIA, and Nokia have plans to promote multiplayer mobile gaming that features excellent graphics and online support. Parks Associates estimates that by the end of 2005, there were about two million online console gamers, 3.5 million MMOG gamers, seven million home LAN gamers, and 15 million casual multiplayer Internet gamers in the United States (see **Figure 1**).

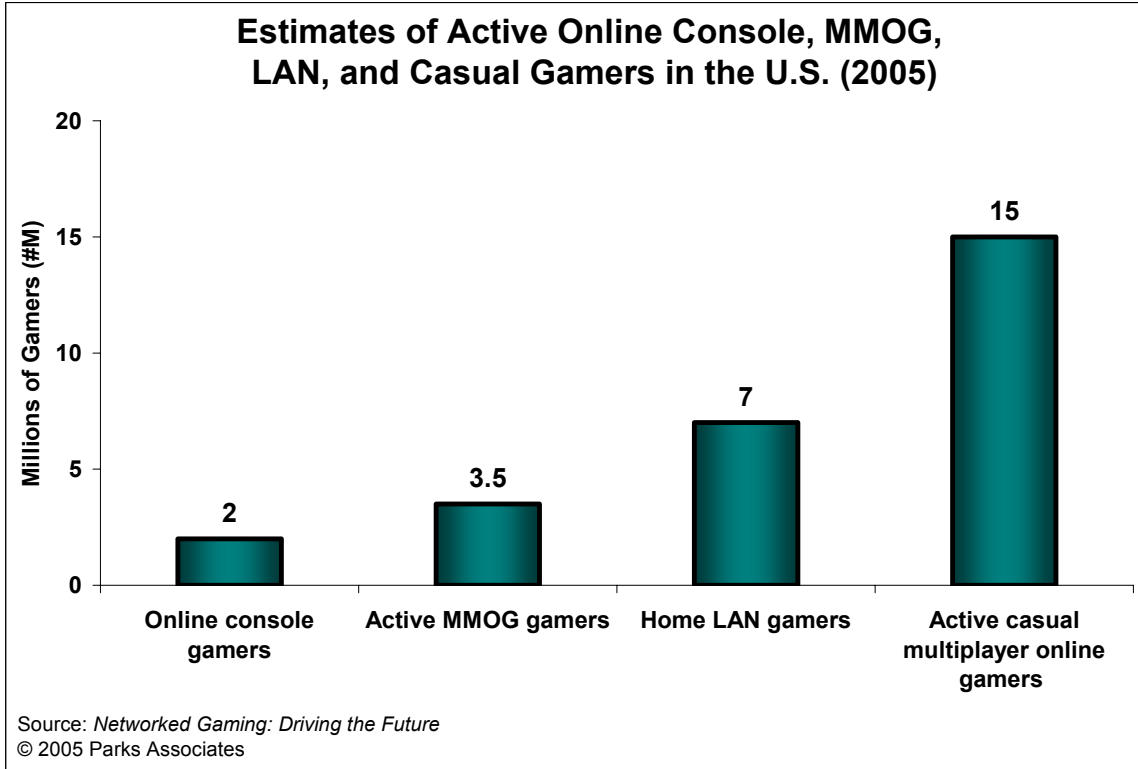


Figure 1 Active Online Console, MMOG, LAN, and Casual Gamers in the U.S.

2.0 Emerging Market Opportunities

2.1 Cross-Platform Gaming

We firmly believe that the future of gaming is networked. Today's gamers, like their predecessors, participate in gaming for not only individual entertainment but also for community belonging. As the processing power and graphics performance of different platforms converge, cross-platform gaming will become more popular and individuals will be able to keep connected with other gamers and access their characters in the virtual world from different devices.

The benefit of cross-platform networked gaming is obvious for gamers. Publishers also have strong incentives to develop cross-platform games, since they do not want to rely solely on the game console platform, which is tightly controlled by the three console makers. In addition, cross-platform networked gaming will provide publishers with a larger audience base and better customer retention. Furthermore, broadband and mobile service providers can share revenue by providing distribution channels and billing services. The benefit of cross-platform networked gaming to console makers is less straightforward at first glance. Nevertheless, we believe the "Big Three" will become more flexible in terms of enabling cross-platform capabilities for next-gen consoles. Game publishers such as Square Enix, which allows connected PC and console gamers to play Final Fantasy XI against each other, have provided precedent for the industry, and other publishers will follow suit. Console makers have strong interest in at least linking devices in their own ecosystems. For instance, Sony and Nintendo will want (and need) to enable cross-platform gaming capabilities between their portable gaming platforms and game consoles. In addition, Microsoft wants to leverage the synergy between Xbox and Windows gaming, and its XNA and Windows Live! initiatives may expand to include cross-platform gaming support.

2.2 Networked Online Gaming

Networked online gaming is a relatively new phenomenon in the gaming world, and inevitably it faces both opportunities and abundant challenges. For instance, casual

multiplayer Internet gaming has relied heavily on advertisement revenues, which can be elusive at times. Also, MMOGs depend heavily on subscription service business models and the core gamer segment, and genre concentration in medieval fantasy-world themes has also lead to cannibalization issues and failures. Gaming companies are recognizing these challenges and trying to diversify their business models and genres. We are seeing tremendous innovation in the networked gaming space, such as setting up premium subscriptions for casual multiplayer gaming; integrating networked gaming with instant messaging programs; and introducing new MMOG models such as advertisement-supported, avatar-based sales, and secondary market exchange models. Many industry pundits note that U.S. gaming industry revenue surpassed Hollywood box office revenue in 2004, without mentioning that the video industry has many more means to generate subsequent revenue from its content. Networked gaming, combined with digital distribution, is helping the gaming industry to evolve from its current model, which depends heavily on retail sales, to more diversified business models.

Networked gaming is changing the look of the gaming industry value chain, which traditionally consisted of only developers, publishers, distributors, and retailers. The network aspect introduces to the value chain new players such as broadband service providers, cellular carriers, Internet portals, online game publishers, and specialized networking companies. These companies face unique opportunities to monetize networked gaming market trends. For instance, broadband service providers may transform from a passive bandwidth provider to an active player that sets up micro-payment infrastructure, bundles gaming services, helps online gaming companies manage their networks, and provides value-added features such as guaranteed quality of service. Another major market trend is console makers' increased focus on networked gaming, which may also impact the future industry landscape. PCs will remain the dominant platform for casual and core networked gaming for the next couple of years, but game consoles are poised to challenge the status quo and benefit from networked gaming.

As games become networked, many new innovations that are already taking place in the Internet space are now trickling down to the networked gaming world. Ideas such as social networking, online commodity exchange, user-generated content, and peer-to-peer networking are all finding their reincarnations in networked gaming. Networked in-game

advertisements, which can offer dynamic advertisements to gamers in real time, will become a new revenue stream for the gaming industry and help advertisers find lost audience. Games that can leverage the social networking phenomenon – including Cyworld and MySpace – and peer-to-peer technologies such as Peer Impact (from Wurld Media) will be able to leverage viral effects and motivate gamers to take more active roles in the value chain, helping networked gaming to reach a much broader audience. Participatory gaming will become a new paradigm in which gamers will not only play games, but also create, market, and distribute games. Second Life, a MMO game created by Linden Labs, allows gamers to own the IP of their own creations, and some gamers have even gone on to sell their in-game creations for real money. Finally, new mobile technologies such as GPS, camera/video phones, mobile broadband, and 3D graphics will enable developers to design games that blend the line between the real world and the virtual world, creating more immersive gaming experiences.

3.0 Revenue Forecasts

With these new trends providing strong drivers, the online gaming market in the United States will witness strong growth in the next five years. Revenues will increase from \$1.1 billion in 2005 to more than \$3.5 billion in 2009 (see **Figure 2**). Networked gaming services, including online console gaming, massively multiplayer online gaming (MMOG), multiplayer Internet gaming, and mobile multiplayer gaming, will account for almost 50% of online gaming revenues in 2009, followed by digital downloads at 23%.

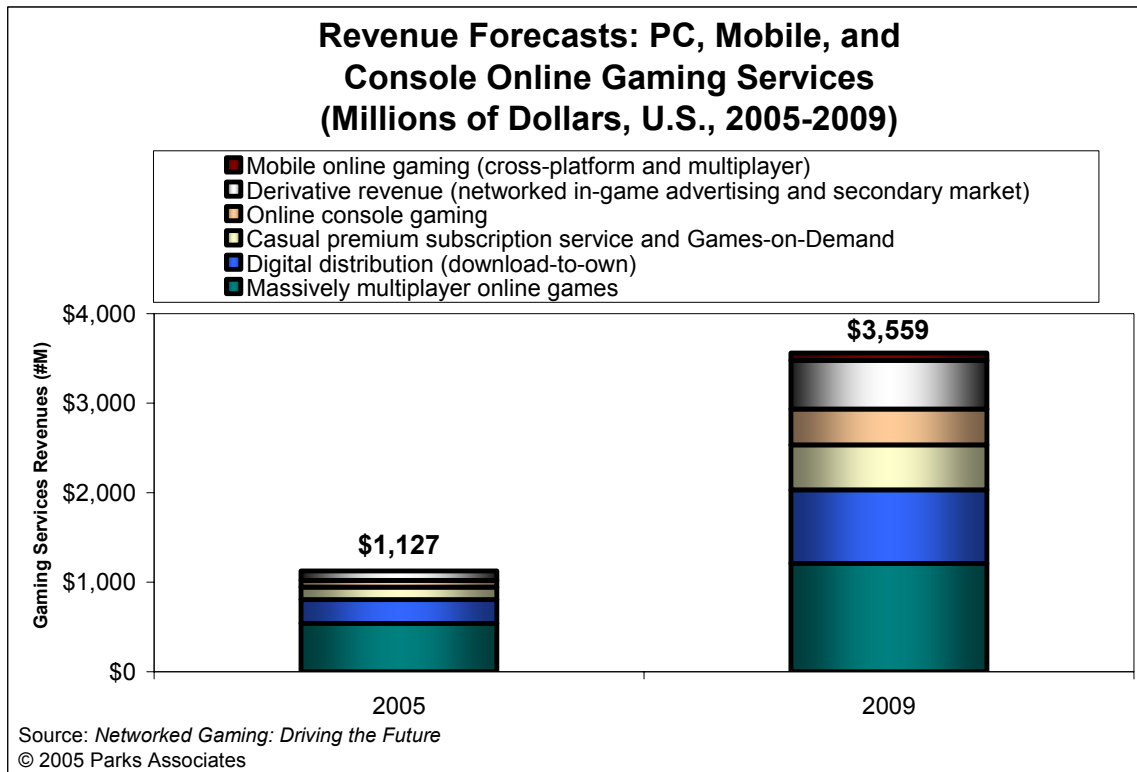


Figure 2 Revenue Forecasts: PC, Mobile, and Console Online Gaming Services

About the Author: Yuanzhe (Michael) Cai is Director of Broadband & Gaming research at Parks Associates. He studies developments in broadband services, broadband technologies such as FTTx and broadband wireless, electronic gaming, and other value-added services. He also follows emerging digital home technologies such as networked storage and whole-home entertainment solutions. Michael has written reports on the Chinese telecom market, broadband wireless, broadband services, storage, entertainment middleware, and gaming. Michael has presented his research in numerous industry events including CES, Supercomm, CONNECTIONS™, and E3.

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About Parks Associates: Parks Associates is a market research and consulting firm focused on all product and service segments that are “digital” or provide connectivity within the home. The company’s expertise includes home networks, digital entertainment, consumer electronics, broadband and Internet services, and home systems.

Founded in 1986, Parks Associates creates research capital for companies ranging from Fortune 500 to small start-ups through market reports, multiclient studies, consumer research, workshops, and custom-tailored client solutions. Parks Associates also hosts two executive seminars, both part of the Fall Focus series, and co-hosts CONNECTIONS™ (in partnership with the Consumer Electronics Association) each year. www.parksassociates.com.